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Research Update:

Wisconsin Energy Corp. And Integrys Energy Group Outlooks Revised To Stable From Negative On Merger; Ratings Affirmed

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Overview

- Wisconsin Energy Corp. (WEC) announced today that it has completed its acquisition of Integrys Energy Group Inc. WEC has changed its name to WEC Energy Group, and Integrys Energy Group has been merged into newly formed intermediate holding company Integrys Holding Inc. Integrys Energy Group will cease to exist.
- We are affirming our ratings on utility holding company WEC and its subsidiary Wisconsin Electric Power Co. (WEPCO), including the 'A-' issuer credit rating. In addition, we are affirming the rating on subsidiary Wisconsin Gas LLC (WG), including the 'A' issuer credit rating.
- We have also affirmed our ratings on utility holding company Integrys and its subsidiaries Wisconsin Public Service Corp. (WPS), Peoples Gas Light & Coke Co. (PGL&C), and North Shore Gas Co. (NSG), including the 'A-' issuer credit rating. We are also assigning our 'A-' issuer credit rating and 'A-2' short-term rating to Integrys Holding Inc.
- At the same time, we are revising the outlook to stable from negative based on our base-case scenario, which includes funds from operations (FFO) to debt on average of 17% over the next few years. Our forecast reflects effectively managed regulatory risk that leads to consistently improved earned returns that are close to the authorized returns.
- We believe that WEC's acquisition of Integrys will enhance the company's position within the "excellent" business risk profile category. We expect WEC to remain within the "significant" financial risk profile category.
- The outlooks on WEPCO, WG, and WPS remain stable, reflecting sufficient regulatory insulation and stand-alone credit profiles that are unaffected by the transaction.

Rating Action

On June 29, 2015, Standard & Poor's Ratings Services affirmed its ratings on Wisconsin Energy Corp. (WEC) and Wisconsin Electric Power Co. (WEPCO), including the 'A-' issuer credit ratings. We also affirmed the ratings on Wisconsin Gas LLC (WG), including the 'A' issuer credit rating. We revised the rating outlook on WEC to stable from negative. In addition, we affirmed the 'A-2' short-term/commercial paper ratings on WEC and WEPCO and the 'A-1' short-term/commercial paper rating on WG.

At the same time, we affirmed our ratings on Integrys and its subsidiaries Wisconsin Public Service Corp. (WPS), Peoples Gas Light & Coke Co. (PGL&C),

and North Shore Gas Co. (NSG), including the 'A-' issuer credit ratings. We revised our rating outlook on Integrys, PGL&C, and NSG to stable from negative. We affirmed the 'A-2' short-term/commercial paper ratings on Integrys, WPS, and PGL&C.

We are also assigning our 'A-' issuer credit rating and 'A-2' short-term rating to Integrys Holding Inc. The outlook is stable.

The outlooks on WEC's subsidiaries WEPCO and WG and Integrys' subsidiary WPS remain stable.

Rationale

The stable outlook on WEC reflects the company's "excellent" business and "significant" financial risk profiles. Under our base-case scenario we expect the company will continue to effectively manage regulatory risk leading to consistently improved earned returns that are close to the authorized returns. As a result, we project that WEC's FFO to debt will range from 16% to 18% on a consistent basis.

WEC has acquired Integrys for \$9.1 billion, which includes the assumption of about \$3.3 billion of Integrys' debt. From a qualitative standpoint, the acquisition strengthens WEC's position within the "excellent" business risk profile category because it enhances scale, scope, operational, geographical, and regulatory diversity. We view the addition of more gas distribution and transmission operations favorably because we regard those businesses as having somewhat lower risk than the vertically integrated electric operations.

Our assessment of an excellent business risk profile incorporates "very low" country risk (U.S.) and our view of the regulated utility sector as having a "very low" industry risk profile that reflects the essential nature of the utility services provided, has material barriers to entry, and essentially operates as a monopoly insulated from market challenges. The utility industry generally exhibits substantial stability in terms of usage and consumption, even after accounting for energy conservation efforts and the economy. The business risk profile is also characterized by strong overall profitability, efficient operations, and above-average scale, scope, and diversification with a very large customer base in multiple states. Importantly, we recognize that WEC has effectively managed regulatory risk in Wisconsin and Michigan, and we expect that management will continue to do so, even in the more challenging Illinois regulatory jurisdiction.

WEC's "significant" financial risk profile reflects our expectations that under our base-case scenario the company's FFO to total debt will be around 16% to 18%. Fundamental to our forecast is base rate relief, an infrastructure surcharge for recovery of gas modernization costs, and no major cost overruns regarding its large construction program.

Liquidity

WEC has "adequate" liquidity to cover its needs over the next 12 months. We expect that the company's sources of liquidity will exceed uses by 1.1x or greater, the minimum threshold for an adequate designation under our criteria, and that the company will also meet our other criteria for such a designation.

Principal liquidity sources:

- Credit availability of \$2.3 billion over the next 12 months.
- FFO of about \$1.8 billion over the next 12 months.

Principal liquidity uses:

- Debt maturities of \$500 million in 2015.
- Capital spending of about \$1.4 billion over the next 12 months.
- Dividends of roughly \$600 million over the next 12 months.

Group influence

The group credit profile (GCP) of WEC is 'a-' and its issuer credit rating is 'A-'. Under our group rating methodology, we consider subsidiaries Integrys, WEPCO, WG, WPS, PGL&C, and NSG as core subsidiaries and integral to the company's long-term strategy and, as such, are highly unlikely to be sold and have a strong commitment from senior management, and therefore we align the ratings of Integrys, PGL&C, and NSG to the GCP.

We consider that there are sufficient measures in place that provide insulation to the Wisconsin utilities that limits the free flow of cash. Most of these provisions are afforded by Wisconsin law and include separateness provisions, dividend restrictions, debt preapprovals, and oversight of the proceeds, and a cap on investments in nonutility assets. In addition, the Wisconsin utilities are further protected given consistent and active regulatory oversight by the Wisconsin Public Service Commission over its operations.

Although there is sufficient regulatory insulation in place, WEPCO and WPS' stand-alone credit profile are the same as the GCP and therefore do not support credit uplift from the GCP.

WG's stand-alone financial measures reflect an "intermediate" financial risk profile, and support a rating that is one notch higher than the GCP.

Outlook

The stable outlook on WEC reflects the company's "excellent" business and "significant" financial risk profiles. Under our base-case scenario we expect the company will continue to effectively manage regulatory risk leading to consistently improved earned returns that are close to the authorized returns. As a result, we project that WEC's FFO to debt will range from 16% to 18% on a consistent basis.

Downside scenario

We could lower the ratings on WEC and its subsidiaries by one notch if the company cannot effectively manage regulatory risk, leading to low earned returns and weaker financial performance including FFO to debt of less than 15% on a consistent basis.

Upside scenario

We could raise the ratings on WEC and its subsidiaries if the company continues to effectively manage regulatory risk, resulting in stronger financial performance including FFO to debt of more than 20% on a sustained basis.

Ratings Score Snapshot

Corporate Credit Rating: A-/Stable/A-2

Business risk: Excellent

- Country risk: Very low
- Industry risk: Very low
- Competitive position: Excellent

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: a-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)
- Stand-alone credit profile: a-
- Group credit profile: a-

Recovery Analysis

- We assign recovery ratings to first mortgage bonds (FMB) issued by U.S. utilities, which can result in issue ratings being notched above an issuer credit rating (ICR) on a utility depending on the rating category and the extent of the collateral coverage. The FMBs issued by U.S. utilities are a form of "secured utility bond" (SUB) that qualify for a recovery rating as defined in our criteria.
- The recovery methodology is supported by the ample historical record of 100% recovery for secured bondholders in utility bankruptcies in the U.S. and our view that the factors that enhanced those recoveries (limited

size of the creditor class and the durable value of utility rate-based assets during and after a reorganization given the essential service provided and the high replacement cost) will persist.

- Under our SUB criteria, we calculate a ratio of our estimate of the value of the collateral pledged to bondholders relative to the amount of FMBs outstanding. FMB ratings can exceed an ICR on a utility by up to one notch in the 'A' category, two notches in the 'BBB' category, and three notches in speculative-grade categories depending on the calculated ratio. We do not notch FMB ratings for companies with ICRs in the 'AA' category.
- The FMBs of WPS and PGL&C benefit from a first-priority lien on substantially all of the respective utility's real property owned or subsequently acquired. Collateral coverage of more than 1.5x supports recovery ratings of '1+' and issue ratings one notch above the ICR.

Related Criteria And Research

Related Criteria

- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Utilities: Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Criteria - Corporates - Utilities: Collateral Coverage And Issue Notching Rules For '1+' And '1' Recovery Ratings On Senior Bonds Secured By Utility Real Property, Feb. 14, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- Criteria - Corporates - Utilities: Notching Of U.S. Investment-Grade Investor-Owned Utility Unsecured Debt Now Better Reflects Anticipated Absolute Recovery, Nov. 10, 2008
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Ratings List

New Rating; CreditWatch/Outlook Action

Integrys Holding Inc	
Corporate Credit Rating	A-/Stable/A-2

Ratings Affirmed

Wisconsin Gas LLC	
Corporate Credit Rating	A/Stable/A-1

Wisconsin Energy Corp.	
Senior Unsecured	BBB+
Junior Subordinated	BBB
Commercial Paper	A-2

Elm Road Generating Station Supercritical LLC	
Senior Unsecured	A-

Wisconsin Electric Power Co.	
Corporate Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
Commercial Paper	A-2

Wisconsin Gas LLC	
Senior Unsecured	A
Commercial Paper	A-1

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
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Wisconsin Energy Corp.		
Corporate Credit Rating	A-/Stable/A-2	A-/Negative/A-2

Wisconsin Energy Capital Corp.		
Corporate Credit Rating	A-/Stable/--	A-/Negative/--

Ratings Affirmed

Integrys Energy Group Inc.	
Senior Unsecured	BBB+
Junior Subordinated	BBB
Commercial Paper	A-2

The Peoples Gas Light & Coke Co.	
Commercial Paper	A-2

Wisconsin Public Service Corp.

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Corporate Credit Rating	A-/Stable/A-
Senior Secured	A
Preferred Stock	BBB
Commercial Paper	A-2

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Integrys Energy Group Inc.		
The Peoples Gas Light & Coke Co.		
Corporate Credit Rating	A-/Stable/A-2	A-/Negative/A-2
North Shore Gas Co.		
Corporate Credit Rating	A-/Stable/NR	A-/Negative/NR

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